A Study of Trade Between Two Irish Economies

by Claire Treacy

Introduction

The opening of the twentieth century saw Ireland as a small open economy heavily dependent on export markets, particularly that of Britain. Rapid political developments produced two small open economies within a mere twenty-five years, one, Northern Ireland, considerably smaller in size, (though not in terms of its industrial base), the other, the Republic of Ireland, now politically independent but still economically dependent on Britain. In this essay I propose to examine the real gross exports from the Republic of Ireland to Northern Ireland since partition. From this I intend to build a picture of the economic integration of the two Irish economies and examine the influences of this integration. A brief outline of both economies is deemed helpful.

Although technically, Northern Ireland is now just another export region of the U.K. for the Republic, a surprisingly high proportion of the Republic's exports are sold on the Northern Ireland market. Contiguity and a history of fully integrated trade are manifestly important factors. Indeed, for manufacturers in Dublin, markets in Northern Ireland are geographically more accessible than markets in the South and West of the Republic, and historically they most certainly have been so.

Despite this apparent entwining of the two economies, their patterns of production, both industrial and agricultural are divergent to the extent that they are not notably interdependent. At the time of partition the Republic was principally involved on agricultural production while Northern Ireland focussed on industrial output. However, the specialized nature of Northern Irish industry required a global market, thus causing it to overlook its small neighbour. This meant that the Republic of Ireland was almost always a net exporter to Northern Ireland.

I intend to examine the details of the Republic's relationship with Northern Ireland over the past sixty-five years, breaking my analysis into two broad sections. To give an overall picture of what has happened between the two economies. I will examine the changes in real exports from the Republic between 1924 and 1990. A more in depth study of the period from 1979 to 1991 will follow, exploring in particular the contributory roles of the sterling/punt exchange rate and the 'security situation', two factors which I regard as salient.

A Historical View of Exports to Northern Ireland

On the first of January 1924, what previously would have been seen as inter-regional trade formally became international trade when the Republic of Ireland commenced exports to Northern Ireland. What took place over the following sixty-five years ran the gamut from out and out protectionism, all the way to the establishment of a complete free trade area. The two countries traded under fixed exchange rate system with resultant equivalent inflation rates until 1979, when the Republic of Ireland, although retaining strong ties with Northern Ireland, broke away from the sterling area to link with the ERM. All of these events are reflected clearly in the real exports index, one of the most remarkable features being that for just over forty years after partition the value of real exports did not increase significantly. Over the next few paragraphs I will highlight and try to explain the most striking points of the changes in real exports, from the Republic of Ireland to Northern Ireland over the broad time span of 1924-1990, before focussing on real exports from 1979 to 1991.

The first trade figures of the new Republic of Ireland date from 1924. Previous to that Ireland had been in commercial union with Britain since 1825. The immediate effect was a downturn in real exports to Northern Ireland. The 'agriculture first' policy in the Republic required free trade, so the imposition of tariffs along the new border was not a factor. Rather the border itself created the blockage, as Kennedy, Giblin and McHugh explain, "Prior to partition ... Belfast was a major port for the exports of goods from all over Ireland. Due to the political and sectarian tensions following partition, this trade was severely curtailed and many areas on both sides of the border were also cut off from their natural hinterland."

Following this uncertain transition period, the coming to power of Fianna Fail in 1932 with their belief in the self-sufficiency of the Republic earmarked the thirties as "..the years of the introduction of all-round protection, the promotion of the home market and the economic war." The so-called 'economic war' of the thirties between the U.K. and the Republic over DeValera's refusal to continue to repay loans of money given in pre-independance land acts continued to rage with a clearly detrimental effect on the Republic's real exports to Northern Ireland, until the far reaching Anglo-Irish trade agreement of 1938, which restored Anglo-Irish trade relations to normal. While this slightly overstates the situation, by the end of 1938 trade had begun to pick up and the value of real exports had passed it's nadir.

The Second World War was a period of depression in the Republic, but entering the fifties trade began to improve and continued to do so into the sixties. At this time government policy was to try to achieve growth through exports and foreign investment. Although the most widely quoted example of this movement towards free trade is the joining of the General Agreement on Trade and Tariffs (G.A.T.T.) in 1967, of greater relevance to real exports to Northern Ireland was the final removal of the tariffs imposed in the thirties by the formation of the Anglo-Irish

Free Trade Agreement Area (A.I.F.T.A.) in 1965. This is a clearly defined turning point in terms of real exports to Northern Ireland, with the value rapidly increasing from that time up to 1978.

Since then the picture has become somewhat clouded by the break with sterling. In fact Prof. McAleese in a comparative study of the two Irish economies cited the former parity between the Irish pound and the pound sterling as an advantage as "..we have no problems arising from the differences in, or changes of, the nominal exchange." Unfortunately, any more recent study of the two economies has no such luxury and the clarity of the two Irish economies cited with which events previous to 1979 were exaimed with is lost. The real exports to Northern Ireland from 1979 onwards will be studied in more detail in the following section, but what is clear at first glance is that what was previously a relatively smooth curve becomes turbulent and unpredictable. It is the aim of the next section to find some explanations for this.

A Closer Look at Influences on Trade (1979-91)

In my experience there is a widespread belief that the exchange rate between the Irish pound and the pound sterling is of great importance to every day interaction between Northern Ireland and the Republic. For anyone living in a border town it is a barometer of the extent of business the commercial outlets can expect. However, economic theory predicts that freely floating exchange rates would automatically adjust to gradual changes in demand, implying that the phenomenon of border towns should be a temporary one, the reality, as any Newry shop holder knows, is different. This may be explained by the fact that the Irish pound cannot appreciate or depreciate against sterling freely, being fixed as it is within the ERM. Sterling can move freely against the Irish pound, but then, would changes in demand for Irish exports have a significant impact on it? It was this line of reasoning which led me to believe that the exchange rate between sterling and punt may not just be a buoy rising and falling in the tides of demand and comparative advantage, but may act as a sluice, inhibiting trade by creating a false comparative advantage in one of the two economies.

Dramatically, this issue came to my attention when sterling dropped out of the ERM in autumn of 1992 and devalued rapidly. The devaluation most certainly affected Northern Irish residents studying in the Republic, and I was curious to see the extent of the impact in general. Unfortunately such data was not available in time for the completion of this study and so I was confined to the period 1979 to 1991.

After regressing the real exchange rate against real exports my results showed that economic theory appeared to prevail over popular belief. All the significance tests indicated that there was no notable linear relationship between real exports from the Republic of Ireland and the sterling-punt exchange rate. An economic explanation of trade between the two Irish economies may therefore, rest in the economic theory books, comparative advantage and barriers to entry commonly being seen as the two most important factors.

However, in the context of Northern Ireland and the Republic there is a further dimension unaccounted for in economic text-books yet already featured in this study, namely the "political and sectarian tensions" referred to by Kennedy, Giblin and McHugh, or the "security situation" as it is euphemistically referred to in the Chief Constable of the Police Authority of Northern Ireland's Annual Reports. This has frequently been cited as the cause of the decline of the economy of Northern Ireland, (i.e. as few firms wish to invest money in an area in which their premises or outlet may be blown up at any time.)

If this was truly the case, then the number of explosions and incendiary devices would be expected to influence the amount of real exports from the republic into Northern Ireland. In this case my regression showed that this most emphatically is not true. Whether this would be true for all imports into Northern Ireland, is difficult to say. It is possible that the proximity of the two economies gives the Republic a more pragmatic view of the Northern Irish security situation and thus renders real exports impervious to the effects for terrorism.

Conclusion

The Republic of Ireland and Northern Ireland are both small open economies and as such are economically dependent on their trading partners. At one time they formed part of the same economy and, if Jacques Delors is to be believed, they will soon be part of a single economy again. Over the past twenty-five years the Republic has begun to export extensively to Northern Ireland, reflecting the abolition of various barriers to entry and the increasing trade consciousness of the Republic's government.

The punt's break from sterling in 1979 restricted the period over which I could carry out my study. This difficulty was exacerbated by the paucity of data on terrorist activity over anything but an annual scale. As a result, I contend that my results may not be entirely conclusive. The unstable international conditions existing in the later half of 1992 and into 1993, however are bound to have a detrimental effect on the Republic of Ireland's real exports in general and real exports to Northern Ireland in particular. It is also possible that a more dynamic model examining rate of change of the exchange rate in relation to real exports may provide a more significant result. That terrorist activity appears to have no detrimental effect on trade is heartening, but may, as previously explained, be an inaccurate reflection of the overall trade pattern with Northern Ireland.

The aim of this study has been to explain the fluctuations in trade and it leads me to conclude that whatever is causing variations in the extent of real exports leaving the Republic for Northern Ireland, it is not the 'security situation' as exemplified by the number of explosions and incendiaries in Northern Ireland nor is it the exchange rate between sterling and punt. What is clear from the earlier part of the study is that the existence of barriers to trade, particularly in the form of tariffs, has a most significant effect on trade.The final conclusion of this study is that I must ruefully agree with Worswick that econometricians "are not ... engaged in forging tools to arrange and measure actual fact so much as making a marvellous array of pretend tools which would perform wonders if ever a set of facts should turn up in the right form."

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The Economist and The Environmentalist - Friends or Foes?

by Sandra McNally

Introduction

Environmentalists and economists are often perceived to have very different views. Most economists are avid followers of free trade and believe in only a limited role for the government. On the other hand, environmentalists tend to emphasise market failure and lobby the government to intervene to protect the environment. A fear is often expressed by economists that the environment will be used by governments as an excuse to pursue interventionist polices.

This essay will use the example of fisheries to show how policies intended to protect the environment can sometimes lead to economic inefficiency. In fact because the government have incomplete information regarding the environment, well-intentioned policy can often be sub-optimal even from a purely environmental perspective. However it is possible in certain cases to design policies that satisfy both economists and environmentalists. Thus the two separate philosophies are not always incompatible. These points shall be illustrated in the following case study from the Irish fishing industry.

Both economists and environmentalists would agree that some form of government intervention is needed to protect fish from over-exploitation. Where fish is an open access resource, i.e. property rights are not well defined, the activities of exploiters would render many types of fish species extinct in the absence of government intervention. Different types of policy can be devised to prevent this. Three such policies will be discussed here and their implications for economic efficiency will be commented upon.

Defining Property Rights - The Example of Aquaculture

When the property rights of finite resources are well defined, producers have an incentive to preserve the stock for future profits. Thus they will not over-harvest and exhaust it. Aquaculture is a suitable example of this fact. The owner is responsible for the controlled raising and harvesting of fish. This exclusive control allows the owner to invest in the resource and to manage it effectively and efficiently. In recognition of the benefits of aquaculture, E.C. structural policy encourages its development. Ireland is classified as a "sensitive region" and is thus eligible for preferential rates of grant aid for this purpose. Thus aquaculture is an example of where economic and environmental objectives can be pursued in tandem. However this technique is not suitable for all types of fish species.

The Command and Control Approach

This is perhaps the most obvious way to reduce over-fishing. The government can increase the real cost of fishing by introducing regulations. If effective, this policy will curtail the yield to a sustainable level. Unfortunately such a policy is often extremely inefficient from an economic perspective. Tom Tietenburg(1992) illustrated this in his case study about how the U.S. government intervened to resolve the problem of over-fishing in the Pacific salmon industry.

Inefficiency resulted from government policy because the fish could not be caught at the lowest possible cost. Regulations were introduced that banned the most efficient techniques of catching fish and placed limitations on fishing times and fishing areas. Thus resources were wasted. In addition a ban on new technology was introduced in response to fears that adopters would increase their catch at the expense of smaller fishermen. Thus this type of policy hindered the development of the industry.

The E.C. Common Fisheries Policy could also be classified as a type of "command and control" approach. Total Allowable Catches (TACs) are fixed each year for certain fish species within different zones of the Community waters. The TACs are then allocated between different member states in the form of quotas. Limitations on the number of fishing days and other such restrictions are imposed so that each country does not exceed its permitted quota.

A major problem with E.C. policy is that quotas are sometimes misallocated. For example, in 1990, quotas for some species in the Irish Sea were so large that they couldn't be filled by fishermen. The fish simply were non-existent. In contrast, quota restrictions in the North Sea recently prevented Scottish fishermen from benefitting from abundant supplies of haddock. This was at a great social cost to local fishing communities. Such quota misallocation often defies the objectives of both economists and environmentalists.

Individual Transferable Quotas

Although it would be almost impossible to introduce such a policy at an international level, there are circumstances within countries where a system of individual transferable quotas could be applied. For example in 1983 the New Zealand government introduced such a policy in an effort to protect its deepwater trawl fishery. This is an economically efficient way to protect renewable resources from over-exploitation. Here the government fix the number of quotas such that the stock cannot be harvested beyond a certain level at which the resource can renew itself. Quotas are allocated to fishermen on some basis, e.g. in proportion to historic catch. Since these quotas are transferable, fishermen with higher costs can make a profit by selling their quotas to those who have lower costs. Thus the entitlement to fish flows naturally to those who benefit most from it because their costs are lower. Individual transferable quotas also encourage fishermen to invest in new technology so as to make better use of their existing quotas and make it profitable for them to purchase quotas from other people.

Conclusion

Although economists and environmentalists often hold different views and look at the world through different eyes, it is possible, at least in some areas for the two groups to be reconciled. Economic theory does have an important role to play and can provide efficient answers to some environmental problems. This becomes more difficult when problems cross national boundaries, where economic theory and environmental idealism are both confronted with an imperfect reality.

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